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LITERATURE REVIEW TO DEVELOP A STUDY ON HOW THE HUMAN FACTOR CAN INFLUENCE THE SUCCESS OR FAILURE OF MERGERS & ACQUISITIONS

Adriana Garibaldi de Hilal*

ABSTRACT

Managing change and its effect on employees in a M&A process is one of the biggest challenges faced by managers. It involves knowing how to deal with expectations, uncertainty and stress in order to minimize the impact of resistance to change, thus fostering employee retention and lower levels of turnover, so as to increase the probabilities of a successful integration and outcome. So, the purpose of this Literature Review was to collect information on theoretical approaches and the state of the art in Mergers & Acquisitions, so as to carry-on a study on how the human factor can influence the success or failure of an acquisition process considering some of the main intervening variables or topics such as stress, turnover, uncertainty and expectations of the employees of the acquired unit.

Keywords: human factor, M&A, organizational change

RESUMO

A gestão da mudança e seu efeito nos empregados em processos de Fusões e Aquisições (M&A) é um dos principais desafios enfrentados por gestores. Implica em saber como lidar com expectativas, incerteza e stress, de forma a minimizar o impacto da resistência à mudança, e assim incentivar a retenção de empregados e níveis mais baixos de turnover, de modo a aumentar as probabilidades de um processo de integração e resultados que sinalizem o sucesso da M&A. Assim sendo, o propósito desta revisão de Literatura foi a de coletar informação sobre abordagens teóricas e o estado da arte em M&A, de modo a poder realizar uma pesquisa sobre como o fator humano pode influenciar o sucesso ou o fracasso de um processo de aquisição, considerando as principais variáveis intervenientes, como por exemplo, stress, turnover, incerteza e expectativas dos empregados da unidade adquirida.

Palavras-chave: fator humano, fusões e aquisições, mudança organizacional

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1 – INTRODUCTION

The experience of working in a company that goes through a M&A process is frequently perceived as traumatic by its employees, mainly in terms of increased uncertainty and stress. Consequently, the organization can be negatively affected in various degrees, depending on how well it is prepared to promptly react and manage the impact of the employees' perceptions on its activities and performance.

Managing change and its effect on employees in a M&A process is one of the biggest challenges faced by managers. It involves knowing how to deal with expectations, uncertainty and stress in order to minimize the impact of resistance to change, thus fostering employee retention and lower levels of turnover, so as to increase the probabilities of a successful integration and outcome.

There has been a growing trend of companies that choose M&A as the preferred alternative in their intent to maximize their value or guided by other motivations, such as monopolistic power, economies of scale, synergies and having a global presence (CARTWRIGHT and COOPER, 1999; BUCKLEY and GHOURI, 2002).

There is a substantial amount of research that examines the strategic and financial aspects of M&A (SEO and HILL, 2005; DATTA, 1991; SCHWEIGER and WALSH, 1990). However, in practice, a large number of M&A processes have not had a positive impact in shareholders' value maximization. Several reasons are given for this poor performance, such as, the inexperience of the involved companies, lack of strategic purpose of the acquiring company and a deficient integration process (LAJOUX and WESTON, 1998). According to a study carried by the auditing company KPMG, the rate of failure of M&A processes ranges from 75% to 83% (NGUYEN and KLEINER, 2003).

Fewer studies take into account the implications and impact of the human factor in a M&A process, as, frequently, these issues are considered of lesser importance when compared to the financial and legal aspects of the process (STOPPER, 1998). But, in fact, it is the human factor that lies at the heart of the problem and is actually responsible for the high percentage of failures when two companies merge or when one acquires another (CARTWRIGHT and COOPER, 1999). Thus, relatively recently, research has shifted to the human side of M&A to understand the psychological and behavioral effects of M&A on employees (HOGAN and OVERMYER-DAY, 1994).

The purpose of this Literature Review was to collect information on theoretical approaches and the state of the art in Mergers & Acquisitions, so as to carry-on a study on how the human factor can influence the success or failure of an acquisition process considering some of the main intervening variables or topics such as stress, turnover,

uncertainty and expectations of the employees of the acquired unit. Seo and Hill (2005) corroborate Hogan and Overmyer-Day (1994) when they state that most authors have examined a simple relationship between a universally important variable, such as communication, and success. To avoid this, this literature review covered the topics that by Buono and Bowditch (1989) considered more relevant when dealing with the human factor). These topics are present in M&A organizational change processes as they have psychological and behavioural effects on employees, and their inclusion can provide a more comprehensive explanation of this complex phenomenon. Moreover, researchers have reported the extreme difficulty in managing the traumatic impacts on employees, of issues such as layoffs, turnover, employee expectations and stress (FRIED et al, 1996; NEWMAN and KRZYSTOFIAK, 1993).

2 – LITERATURE REVIEW

In a globalized world where companies, in their search for competitive advantage, often face the alternative of adopting a growth strategy or end up being acquired by a competitor, M&A are a frequent choice (CEAUSESCU, 2008). A merger implies in the consolidation of two organizations into one; an acquisition entails the buying process of a company by another, where only one of them will have control of the new resulting organization.

M&A can impact organizations in different ways regarding synergies, results and their integration process (BUONO and BOWDITCH, 1989). Although the human factor has been acknowledged as a key factor in the success or failure of a M&A process, organizations tend to underestimate its importance in favour of financial, commercial and other aspects of the deal (RANKINE, 1998).

Successful M&A result in increasing market share, core organizational capabilities, knowledge and expertise (HITT, IRELAND and HARRISON, 2001; MCINTYRE, 2004; KONGPICHAYANOND, 2009). Of course, business strategies and financial issues are critical in successful M&A (KONGPICHAYANOND, 2009). However, overemphasis of these areas can also lead to failure, which occurs when organizations overlook the importance of their human resources (GROTEHUIS and WEGGEMAN, 2002; MCINTYRE, 2004; MITLETON-KELLY, 2006).

The organizational change that is part of a M&A process usually causes negative reactions and resistance among employees as, in general, it increases uncertainty and stress even when change can be, at the rational level, perceived as positive. These feelings

of resistance to change many times end up causing the failure of what could otherwise be a successful M&A process (ARMENAKIS and BEDEIAN, 1999).

The topics that are considered more relevant when dealing with the human factor (BUONO and BOWDITCH, 1989), within the scope of this case study, are:

1. Resistance to change

Resistance to change is defined as any attitude or behaviour, anchored in emotions, that frustrates the objectives of the organizational changes proposed by a company. In terms of attitude, there is a psychological rejection regarding the real need to change, while behavioural resistance is represented by actions that denote unwillingness to accept the modifications and, consequently, lack of commitment to support organizational change, which endangers its chances of success (CHAWLA and KELLOWAY, 2004).

Resistance can progressively increase and the only way to deter this trend is treating the situation with transparency, emphasizing the potential benefits that will derive from change (APPELBAUM et al., 2000) as well as understanding the emotional experience of the individuals affected by the organizational change (KIEFER, 2002). Resistance can have different levels of intensity: it can be directly related to change when employees have no certainty of the validity and usefulness of the change proposed; it can be linked to issues such as lack of trust, cultural differences, low perceived levels of respect, perception of inequity or fear of not being able to develop the new skills required due to this change. The higher the level of intensity the stronger the resistance to change and the longer it takes for it to be overcome (MAURER, 1996; KOTTER and SCHLESINGER, 1992).

Frequently, from a managerial perspective, resistance to change is viewed as irrational (PIDERIT, 2000). For Kiefer (2002) and Reiss (1995) the underlying assumption is that because people fear change in general and therefore oppose it, resistance is seen as an emotional barrier (REISS, 1995) that can prevent people from understanding rational argument. From this perspective, negative emotions are perceived as "dysfunctional," and therefore the experience of change is portrayed as a problem.

On the other hand, emotions can also be viewed as part of the individual and social experience of change, where human experience is fundamentally characterized by emotion (GREENBERG and RHODES, 1991) and emotions reflect the interpretation of the ongoing events (WEISS and CROPANZANO, 1996). Consequently, emotions can be seen as a vital part of the construction of the meanings of change, thus making it possible to acknowledge both positive and negative emotions as a major motivational factor in employees' behavior at work, structuring the way they think, feel, and behave. In this

sense, negative emotions are not necessarily dysfunctional, but help individuals adapt to difficult situations of organizational change. (KIEFER, 2002).

2. Uncertainty and employee expectations

The word uncertainty can be defined as the psychological state expressed by the doubt that results of the ambiguity perceived in the meaning of a specific event, besides being a source of tension during a M&A process. This is due to the fact that the individuals who work in the companies involved in a M&A process cannot measure the real impact of the process on issues such as: their respective future roles in the new organization, the probability of keeping their jobs or being laid-off, what organizational culture is going to prevail and what type of adaptation will be required of them (BORDIA et al., 2004). M&A processes involve disrupting the existing cultural, structural, and job arrangements and creating new arrangements. However, the transitions are typically neither clear-cut nor short term, often meaning a long period of organizational drift (MARKS and MIRVIS, 1992), which usually triggers uncertainty (e.g., IVANCEVICH et al., 1987).

Although the feeling of uncertainty can produce positive behaviours such as higher employee commitment and loyalty, it can also foster negative behaviours, such as absenteeism and acts of sabotage (BUONO and BOWDITCH, 1989) as well as lower work motivation and higher job dissatisfaction (e.g., IGBARIA and GUIMARAES, 1993; SIMS and SZILAGYI, 1975). How this feeling is channelled, will depend, to a high degree, on how the expectations of the employees of the acquired company are managed.

Expectations are defined as the beliefs that individuals have in connection to “what leads to what” in the environment that serves as a visual map of the organization (PORTER, LAWLER III, and HACHMAN, 1975). Expectations are constantly modified and contingent on the environment to which employees are exposed to, as a result of interactions among individuals or of the communication strategy adopted by the organization. Thus, expectations are influenced by different factors such as, the stage of the M&A process, the role of employees and their perception of the integration process. This indicates that the way the acquiring company manages the expectations of the employees of the acquired company or company unit is paramount to the success or failure of the M&A process (HUBBARD and PURCELL, 2001). To address this issue, researchers emphasize the importance of communication (BASTIEN, 1987) as will be explained in item 7 of this literature overview.

3. Commitment

Organizational commitment can be defined in terms of the ties employees form with the company. The psychological link with the organization is a multidimensional construct that can lead to three different forms of commitment (MEYER and ALLEN, 1991):

- Affective commitment: refers to the emotional ties of the employees, their involvement and identification with the organization.
- Continuous commitment: related to the costs of an employee leaving the company, i.e., it considers the benefits associated to his permanence versus his personal costs for leaving the organization.
- Normative commitment: based on the obligation and moral duty to persist and remain at the company.

Although companies prefer employees with affective commitment, the tension and uncertainty in the work environment causes frustration in these employees and a possible reduction of their affective commitment (BUONO and BOWDITCH, 1989) negatively affecting performance when the organization most needs it (VAN DICK, ULLRICH, and TISSINGTON, 2006).

During a M&A process the new organization should try to neutralize the negative impact of tension and uncertainty focusing its efforts on maintaining or increasing affective commitment, thus avoiding undesired levels of performance (ROUNDY, 2010) and fostering employee identification with the acquiring company. Researchers have suggested that it is important to assess how strongly employees identify themselves with the acquired company and then take steps to ensure that their identification with the acquiring company is seen as more attractive (TERRY and O'BRIEN, 2001). In addition, the new management should attempt to develop a common in-group identity by encouraging interaction between the two groups in a positive, cooperative and supportive environment (GAERTNER et al, 1990; BROOKS, ROSSON and GRASSMANN, 2005).

4. Stress

As stress is determined by the subjective perceptions of individuals and not by objective reality, the sources of those perceptions have to be clearly identified by managers within the context of a M&A process (MARKS and MIRVIS, 1985).

In an environment subject to organizational change, the feeling of uncertainty produces stress among the employees, thus affecting their perceptions, judgement and interpersonal relations (APPELBAUM et al., 2000).

Each M&A process has its own particularities that generate different levels of stress. Each M&A process creates a new scenario with different behaviours and outcomes. Moreover, each stage of a M&A process can produce specific levels of stress (IVANCEVICH, SCHWEIGER, POWER, 1987).

The first stage of a M&A process – the planning phase – consists of the evaluation of a possible merger or acquisition. Although this is usually a phase where confidentiality prevails and actions are conducted with discretion, rumours tend to emerge either internally in the company or externally in the market. Thus, uncertainty and stress start to affect employees' perceptions.

The second stage – the implementation phase – starts when one of the companies openly approaches another. At this moment, individuals start to make sense of the scenario of a possible merger or acquisition generating more stress among the employees of the involved organizations.

The first and second stages both take place before the acquisition is formalized. The third stage – the transition phase – is the “waiting period for things to actually happen” when expectations of organizational change and lay-offs intensify causing high uncertainty, although the name of the acquiring company (or partner in case of a merger) is already public knowledge.

The fourth stage – the integration and stabilization phase – occurs when the transition is completed and the new organization stabilized. Anyway, this is still a stressful stage for employees as it implies the implementation of organizational change and adaptation to a new reality.

Thus, the role of management before, during and after the M&A process is fundamental to try to minimize the perceptions and feelings of uncertainty, fear, anxiety and stress so that the process can develop in the best possible way. This requires considering other dimensions of the work environment besides the core characteristics of the job task, such as career paths, work relationships, support networks, status differences, geographic specificities, and job security. These can all play a role in reducing stress and shaping employee attitudes and behavior after an acquisition (SCHWEIGER and WALSH, 1990).

5. Turnover

- Turnover is an expected side effect of a M&A process and should be managed and understood to minimize its cost and its negative impact on the process (APPELBAUM et al., 2000).

- In terms of turnover, three different scenarios can be identified (MORRELL, LOAN-CLARKE, WILKINSON, 2004):
- Unavoidable turnover: the employees who leave the company are considered necessary losses. In this case, the cost of the loss can be measured against the benefits that are expected from the implementation of change.
- Avoidable turnover: implies an unnecessary loss of employees who could add value to the company. In this instance, preventive measures may avoid or reduce the loss of those employees.
- Mixed turnover: it is a mixture of unavoidable and avoidable turnover and its impact can be difficult to evaluate. This case may require a tailor made approach, as neither preventive nor reactive control measures may prove appropriate for the situation.
- Researchers have consistently found that employees' perceived fairness of how both surviving and displaced employees are treated during the post merger integration period substantially influence their attitudes and behaviors, such as turnover (FRIED et al., 1996; GUTKNECHT and KEYS, 1993).
- Cobb, Wooten and Folger (1995) specified several approaches to manage organizational perceptions of fairness during an acquisition process:
- Outcomes should be based on the needs of the organization and those of the employee. For example, employees should receive training based on the criticality of their role in the new organization and their deficit of skills for those roles.
- New human resource management policies and procedures should use accurate, objective, and unbiased criteria and be consistent across both people and time (HARRISON, 1998; KRUPAR and KRUPAR, 1988).
- Displaced employees should be treated with fairness and respect, providing adequate explanations of the need for change, and acknowledging the adversities that employees are facing (FRIED et al., 1996; GUTKNECHT and KEYS, 1993).

6. Employee retention

Employees evaluate if the culture of the new organization fits with their values and expectations, if their career prospects are in accordance with their aspirations and if they envision the possibility of future opportunities (SIEHL, SMITH and OMURA, 1990). Moreover, acculturation has been identified as a critical success factor for employee

retention during the integration process (LARSSON and LUBATKIN 2001; NAHAVANDI and MALEKZADEH 1988).

The behaviour of key employees during a M&A process is also influenced by the strategy implemented by the new organization. There are four basic possible strategies (SIEHL, SMITH and OMURA, 1990):

In the first strategy - Pillage and Plunder - the acquiring company targets specific assets of the acquired one. In this case, time is a priority and employees are usually considered of secondary importance. Consequently, given the opportunity, employees would tend to leave the company.

In the second strategy - The One Night Stand - as the assets acquired are different from those of the acquiring company, the buyer would probably need the support of the acquired organization to guarantee the success of the M&A process. In this case, employees would tend to remain in the new organization.

In the third strategy - Courtship but Just Friends - there is the explicit intention of a friendly integration process between the involved companies, which implies a work relationship with low levels of organizational change. In this case, talents could also remain in the new organization, as they would contribute to a successful transition.

Lastly, the fourth strategy - Love and Marriage - demands a high level of employee commitment during the integration process. However, in the long run, these employees could feel forced to leave the new organization because they represent the "old image" of the acquired company.

Vaara, Tienari and Santti (2003) demonstrate the importance of the post-merger integration strategy regarding employee retention, particularly in terms of surmounting the hurdles of culture clashes, communication barriers, and we-they orientations. They also emphasize the critical roles that organizational managers play in paying attention to these hurdles and in socially constructing a new reality for their new combined organizations.

7. The role of communication

In a M&A process, companies frequently do not use their communication tools in an effective way. In many cases, or they use them in inefficient ways, or they do not communicate what they should in order to keep employees well informed and thus minimize the negative side effects of the weary and consuming M&A process (BUONO and BOWDITCH, 1989).

For Appelbaum et al. (2000), communication should be understood as the most important issue in a M&A process. This is due to the fact that communication can

influence, positively or negatively, the adoption of a new organizational culture, the change process as a whole, the level of employee stress, the management of uncertainty and employee expectations, the level of employee satisfaction and performance.

Thus, communication should provide timely and accurate information about what will happen to the organization and employees' jobs (e.g., GARPIN and HERNDON, 2000; SCHWEIGER and DENISI, 1991). Based on this, the recommendation is for communication to start early and be ongoing (NAPIER, SIMMONS and STRATTON, 1989) including providing employee assistance programs and conducting meetings where employees can voice their views openly, listen to others, and take solace in the fact that others are experiencing the same emotions (FUGATE, KINICKI, and SCHECK, 2002). Bastien (1987) indicated the need of two-way communication, which consists of both active listening to the sources of stress, uncertainty and role related issues and promptly responding to them.

According to Kongpichayanond (2009), the employees of the acquired company are looking for a shared vision or scenario concerning the future developments and directions for the business. In particular, they want to know whether a new management will be taking over or whether the existing management and its directions are to continue as before. They also want to know the new management's business philosophy and they want to know of any major changes intended. The employees of the acquired company know that the buyer has the potential to exercise considerable power to change the business - the possibilities of which can arouse feelings both of opportunity and fear - and they initially expect the buyer to use that power. If the buyer does not address these expectations by communicating a clear vision for the future, or if this is done in a clumsy fashion, fear, stress and uncertainty are prone to increase.

Moreover, Marks and Mirvis (1992) also suggested that strong managerial leadership can help to develop and clarify employees' new roles in the acquired organization. This may require that managers hold one-on-one discussions with employees to negotiate and clarify role expectations, as core job characteristics (skill variety, task identity, task significance, task autonomy, and task feedback) influence perceptions of the work environment and in turn influence motivation and job satisfaction (HACKMAN and OLDHAM, 1975).

Honorable rhetoric and communicating a clear vision go some way towards enhancing the image of a new owner. The eventual test, however, is whether the buyers' subsequent managerial actions live up to the expectations created (KONGPICHAYANOND, 2009). So, it is also important to enhance employees' perceptions of control, for example, allowing employees to participate in decision making

during and after the M&A (FUGATE, KINICKI and SCHECK, 2002), encouraging them to participate in job redesign processes (CAMERON, FREEMAN and MISHRA, 1991) and, finally, training employees to adjust to job changes is also frequently recommended (SCHWEIGER, IVANCEVICH and POWER, 1987).

All in all, theory indicates that the best approach for a corporation to deal with the anxiety, uncertainty and stress that are part of a M&A process requires the involvement of all the employees in the adopted communication strategy.

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